

Kluwer Competition Law Blog

COVID-19 and the ‘failing firm’ defence in merger proceedings

Tommi Lahtinen (European Commission) and Pieter Huizing (Allen & Overy) · Friday, March 20th, 2020

COVID-19, or more commonly known as the Coronavirus, has spread across the European Union (“EU”) like wildfire. Several Member States have closed their borders and ordered travel prohibitions, as well as the closing of schools, shops and restaurants. This new status quo will likely remain for several weeks if not months, possibly leading to severe financial consequences. The European Commission (“the Commission”) has recognised the seriousness of the situation by [standing ready to accept exceptions](#) to its State Aid rules, allowing for companies to seek support in these difficult times.

Be that as it may, the regrettable truth is that many companies, irrespective of their size and industry, may be facing bankruptcy in the aftermath of COVID-19. This, consequently, may lead to a situation in which better positioned companies with sufficient access to financing will become keen to seize a unique opportunity to purchase the business operations of a struggling competitor. It is hence not unlikely that in the coming period, the Commission and national competition authorities will regularly be asked to assess mergers which from a purely competitive perspective may be problematic but may nevertheless satisfy the ‘failing firm’ defence.

The ‘failing firm’ defence

The ‘failing firm’ defence in merger proceedings can be considered a last resort argument, which may drag a notified transaction over the line if the authority could not be convinced of the lack of substantive concerns. The defence is not very often relied upon, and rarely accepted. Relying on the ‘failing firm’ defence means that regardless of potential competitive issues of some sort, the argument is made that the only alternative would be bankruptcy of the target business and that this would be more harmful to competition than the proposed acquisition. In other words, the acquisition is presented as a ‘rescue merger’ and sold as the least adverse outcome when compared to the counterfactual.

Indeed, paragraph 89 of the [Horizontal merger guidelines](#) explain that an otherwise

problematic merger may nevertheless be compatible with the internal market if one of the merging parties is a failing firm. Paragraph 90 continues to specify three cumulative conditions which must be satisfied for a successful ‘failing firm’ defence: (i) the allegedly failing firm would in the near future be forced out of the market due to financial difficulties if not taken over by another company, (ii) there is no less anti-competitive alternative than the proposed merger, and (iii) in the absence of a merger, the assets of the failing firm would inevitably exit the market. These conditions have been applied by the Commission, for instance, in the [Aegean/Olympic II](#) merger.

To satisfy the first condition, it is for the notifying parties to provide sufficient evidence of the failing firm’s financial difficulties. For instance, internal documentation demonstrating denied access to needed finance and/or failed attempts of re-structuring could be enough to satisfy this condition. In the [Aegean/Olympic II](#) case, the drastically changed market conditions (the on-going economic crisis in Greece) combined with Olympic’s financial troubles played a significant role, leading the Commission to conclude that Olympic would be forced to leave the market soon, with or without the merger.

In essence, the second condition is fulfilled when it can be demonstrated that there are no alternative buyers available or that an acquisition by another company does not lead to a substantially less anti-competitive result. In the [Aegean/Olympic II](#) case, there were no credible alternative buyers, and the emergence of one in the near future was unlikely. Should the ‘failing firm’ defence become relevant in the coming months, it is indeed the second condition which may be most challenging to meet. The Commission will want to assess whether it is sufficiently unlikely for the failing firm, or its key assets, to be acquired by a party presenting a less anti-competitive alternative. In this respect it normally requires the demonstration of serious and credible efforts to seek alternative options. But such efforts take time, which is a scarce asset when faced with financial distress. Also, from the buyer’s perspective there is of course little incentive to allow the target business to extensively explore alternative options.

Finally, the third condition requires the notifying party to demonstrate that should the target company fail, its assets would inevitably exit the market and/or its market share will go to the notifying party. This could be the case, for instance, when the notifying party is the only market player capable of supplying the failing firm’s customers, or if those customers have already approached it to supply them. In the [Aegean/Olympic II](#) case, it was the Commission’s analysis that all of Olympic’s market shares in the relevant air routes would, in any event, accrue to Aegean since they were (quasi-)duopolies between Aegean and Olympic, and entry by third airlines in the foreseeable future was unlikely.

How would all this apply in the aftermath of COVID-19

It has to be recognised that the [Aegean/Olympic II](#) merger took place amid a much longer and (hopefully) more severe economic crisis than what the COVID-19 may likely result in. At the same time, the speed at which market conditions are worsening

under the current circumstances is unbelievable. Still, the basic principles of the assessment of a 'failing firm' defence will apply now as they have before. After all, the principles applicable to a 'failing firm' defence are rather straightforward. What these times do call for is as swift and flexible approach as possible by authorities, as notifying parties are unlikely to have the 'luxury' of a long review period to conclude that a firm would in the near future indeed likely to be forced out of the market due to financial difficulties if not taken over by their competitor. However, the reality is that the Commission and national authorities can clear mergers only once they have all the necessary information to conclude that it does not lead to an anti-competitive result. As such, notifying parties should be ready to quickly present a credible story to meet the high thresholds for a successful failing firm defence. As before, the Commission and national authorities will be wary of attempts to effectuate truly anti-competitive mergers under the cover of the current crisis.

At the time of publishing, one of the authors, Tommi Lahtinen, was a Blue Book Trainee at the European Commission. This blog post has been written in a personal capacity. The views expressed are purely those of the writer and may not in any circumstances be regarded as stating an official position of the European Commission.

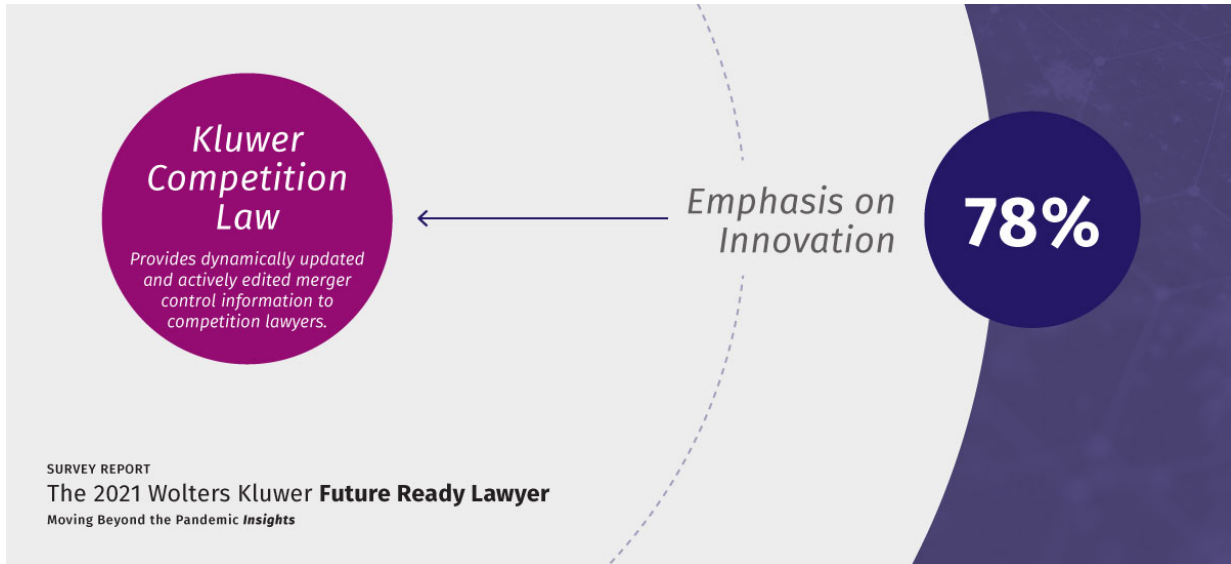
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